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No. _____

In The

Supreme Court of the United States

October Term, 1994

WILLIAMSON COUNTY, TENNESSEE,

Petitioner,

v.

BONDHOLDER COMMITTEE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

STEPHEN P. JORDAN
YOST AND ROBERTSON
P.O. Box 1544
Franklin, TN 37065-1544
(615) 790-9678
Counsel for Petitioner

March 1995

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

Whether § 506 of the Bankruptcy Code voids that portion of a State's statutory lien securing penalty, attorneys' fees, and court costs on delinquent property taxes; and if so, whether § 506 as so applied to a State's lien violates constitutional principles of federalism and the Tenth Amendment.

TABLE OF CONTENTS

Page

Table of Authorities iii

Opinions Below 1

Jurisdiction and Rule 29.4(b) Statement 2

Constitutional and Statutory Provisions Involved... 2

Statement 3

Reasons for Granting the Petition..... 6

A. Certiorari should be granted because the courts below and other federal courts have erroneously elevated the Supreme Court's dictum in *Ron Pair* into a problematic, unintended holding of law 6

B. Certiorari should be granted because the Sixth Circuit erred in refusing to follow this court's "plain statement rule" of federalism when applying § 506 to a local government property tax lien..... 13

C. Certiorari should be granted because the issues involved in this case have nationwide significance 15

Conclusion 18

Appendix..... 1a

TABLE OF AUTHORITIES

Page

CASES:

Allied-Bruce Terminix Cos. Inc. v. Dobson, ___ U.S. ___, 115 S. Ct. 834, 130 L. Ed. 2d 753 (1995) 14

Ashton v. Cameron Water Dist. No. 1, 298 U.S. 513 (1936) 5, 10

BFP v. Resolution Trust Corp., ___ U.S. ___, 114 S. Ct. 1757, 128 L. Ed. 2d 556 (1994) 13, 15

C&A Carbone, Inc. v. Town of Clarkstown, N.Y., ___ U.S. ___, 114 S. Ct. 1677, 128 L. Ed. 2d 399 (1994) 11

California State Bd. of Equalization v. Sierra Summit, 490 U.S. 844 (1989) 13, 15

City of St. Louis v. Wiggins Ferry Co., 78 U.S. (11 Wall.) 423 (1870) 9

County of Lane v. Oregon, 74 U.S. (7 Wall.) 71 (1869) 10

Cox v. Lott, 79 U.S. (12 Wall.) 204 (1871) 10

Dewsnup v. Timm, 502 U.S. 410 (1992) 8, 14

Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) 5, 11, 12, 14

Gregory v. Ashcroft, 501 U.S. 452 (1991) 5, 13, 14

Hooten v. Carson, 186 Tenn. 282, 209 S.W. 2d 273 (1948) 9

In re Building Technologies Corp., 167 Bankr. 853 (Bankr. S.D. Ohio 1994) 8

In re Martin, 106 Bankr. 334 (Bankr. D. Me. 1989) 8

In re Parr Meadows Rac'g Ass'n, Inc., 880 F. 2d 1540 (2nd Cir. 1989) 9

TABLE OF AUTHORITIES – Continued

Page

In re Pointer, 952 F. 2d 82 (5th Cir. 1992) 9

Nathan v. Louisiana, 49 U.S. (8 Howard) 73 (1850) 9

New York v. U.S., ___ U.S. ___, 112 S. Ct. 2408, 120 L. Ed. 2d 120 (1992) 11

New York v. U.S., 942 F. 2d 114 (2nd Cir. 1991) 11

Rake v. Wade, ___ U.S. ___, 113 S. Ct. 2187, 124 L. Ed. 2d 424 (1993) 8

South Carolina v. Baker, 485 U.S. 505 (1988) 12

State Bd. of Tax Comm'rs. of Indiana v. Jackson, 283 U.S. 527 (1931) 9

Swarts v. Hammer, 194 U.S. 441 (1904) 13

United States v. Ron Pair Enters., 489 U.S. 235 (1989) 5, 6, 7, 8, 9, 11

CONSTITUTIONAL PROVISIONS AND STATUTES:

U.S. Const. amend. X 3

U.S. Const. art. I, § 8 2

11 U.S.C. § 103 (a) 15

11 U.S.C. § 506 ..... *passim*

28 U.S.C. § 151 3

28 U.S.C. § 152 (a) (2) 3

28 U.S.C. § 157 3

28 U.S.C. § 158 3

28 U.S.C. § 1254 (1) 2

TABLE OF AUTHORITIES – Continued

Page

28 U.S.C. § 1294 3
28 U.S.C. § 1334 (a) 3
28 U.S.C. § 2101 (c) 2
28 U.S.C. § 2403 (a) 2
Ariz. Rev. Stat. Ann. § 42-312 16
Ark. Code Ann. § 26-34-101 16
Cal. Gov't Code § 43001 16
Colo. Rev. Stat. Ann. § 39-1-107 16
Conn. Gen. Stat. Ann. § 12-172 16
Ind. Code Ann. § 6-1.1-22-13 16
Kan. Stat. Ann. § 79-1804 16
Ky. Rev. Stat. Ann. § 134.420 16
Mass. Gen. Laws Ann. ch. 60, § 37 16
Mich. Comp. Laws Ann. § 211.40 16
Mo. Ann. Stat. § 137.085 16
Nev. Rev. Stat. Ann. § 361.450 16
N.J. Stat. Ann. § 54:5-6 16
N.M. Stat. Ann. § 7-38-48 16
N.C. Gen. Stat. § 105-355 16
N.D. Cent. Code § 57-02-40 16
Ohio Rev. Code Ann. § 323.11 16
Okla. Stat. Ann. tit. 68, § 234 16
Ore. Rev. Stat. § 311.405 16

TABLE OF AUTHORITIES – Continued

Page

S.C. Code Ann. § 12-49-10 16

Tenn. Code Ann. § 67-5-2101 ..... 2, 3, 16

Tex. Tax Code Ann. § 32.01 16

Va. Code Ann. § 58.1-3340 16

Wash. Rev. Code Ann. § 84.60.010 16

Wis. Stat. Ann. § 74.01 16

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Petersen, *Local Government's Fiscal Recovery: Don't Count on Property Taxes*, Governing: The Magazine of States and Localities, Feb. 1993 17

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PETITION FOR A WRIT OF CERTIORARI

Williamson County, Tennessee respectfully petitions this court for a writ of certiorari to review the judgment of the United States Sixth Circuit Court of Appeal.

OPINIONS BELOW

The Sixth Circuit's opinion, set for publication but as yet unpublished, is in the appendix to this petition at Appendix 1a. The U.S. district court's opinion, published at 152 Bankr. 727 is herein at Appendix 20a. The U.S.

Bankruptcy Court's decision, published at 134 Bankr. 267 is *infra* at Appendix 33a.

JURISDICTION AND RULE 29.4(b) STATEMENT

The Sixth Circuit Court of Appeals entered its judgment on December 13, 1994. Appendix at 1a. This court's jurisdiction is invoked under 28 U.S.C. § 1254 (1). This petition is timely-filed under 28 U.S.C. § 2101 (c). 11 U.S.C. § 506's constitutionality has not been previously certified to the Attorney General. 28 U.S.C. § 2403(a) maybe applicable.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In dealing with the general allowance of claims and the survival of liens against a bankrupt, the current bankruptcy code provides: "To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." " . . . To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void . . . " (11 U.S.C. § 506 [b] and [d] [1988]).

Tenn. Code Ann. § 67-5-2101 (1994) gives Tennessee counties a first-in-priority lien against locally-taxed property for property taxes, penalty, interest and costs. Appendix at page 48a. The applicable constitutional provisions, U.S. Const. art. I, § 8 (the Bankruptcy Clause) and

amend. X (Powers Reserved to the States) are set out in the Appendix at page 48a.

STATEMENT

This case presents an important federalism issue: Congress' ability under the Bankruptcy Clause to destroy a state's sovereign power to tax local, intrastate property. The dispute arose out of a Chapter 11 bankruptcy reorganization. The U.S. Bankruptcy Court for the Middle District of Tennessee had jurisdiction over the case pursuant to 28 U.S.C. § § 151, 152 (a) (2), 157 and 1334 (a). On appeal, the U.S. District Court for the Middle District of Tennessee had appellate jurisdiction under 28 U.S.C. § 158 (a). The U.S. Sixth Circuit Court of Appeals had appellate jurisdiction pursuant to 28 U.S.C. § § 158 (d) and 1294.

Brentwood Outpatient, Ltd. (hereafter "debtor" or "debtor-in-possession"), a Tennessee limited partnership, filed Chapter 11 bankruptcy in August 1989. Petitioner thereupon timely-filed a secured claim for $41,660.95 in unpaid base (principal) real property taxes, statutory interest, statutory penalty, statutory attorneys fees, and court costs of collection, all as allowed by Tenn. Code Ann. § 67-5-2101.

The bankrupt debtor-in-possession had outstanding revenue bonds secured by the debtor-in-possession's taxed real property, a four-million dollar office facility.[1]

[1] There is no dispute that the value of the property exceeded petitioner's claim and petitioner's claim was thus oversecured.

The holders of those bonds formed a committee and proposed a competing reorganization plan, which provided for the bondholders to take over the facility. The bondholders' plan, which promised to pay the county's allowed secured claim in full, gained the most votes and was confirmed by the bankruptcy court in 1991. However, on May 31, 1991 – the very last day before the effective date of that plan – the bondholders' committee objected to petitioner's lien/secured claim and sought a determination that a portion of the county's claim should be disallowed as a matter of law. The U.S. Bankruptcy Court allowed, under 11 U.S.C. § 506 (b), the county's secured claim in part and denied it in part and destroyed, in part, petitioner's senior-in-priority property tax lien.

The county timely appealed the legal issues: whether Congress, in enacting § 506 of the Bankruptcy Code of 1978 intended to destroy existing statutory liens for local property taxes; and whether, considering the Tenth Amendment and principles of federalism, Congress under the Bankruptcy Clause *can* constitutionally destroy such liens. The district court affirmed the bankruptcy court.

The county timely appealed to the U.S. Sixth Circuit Court of Appeals, again arguing that (1) Congress never considered the question nor intended for § 506 of the bankruptcy code to destroy a state's sovereign power to tax real property wholly located within a state's borders, and (2) if Congress did so intend – or if § 506 could be so construed and applied – then § 506 was unconstitutional as applied.

The U.S. Sixth Circuit disallowed the non-interest portion of the county's statutory lien/claim on the basis of *United States v. Ron Pair Enters.*, 489 U.S. 235 (1989) (holding that "the natural reading of § 506 [b] of the bankruptcy code entitles the holder of an oversecured claim to post-petition interest"). Appendix at page 11a. The Sixth Circuit opined that any real analysis of the constitutional issue under the Bankruptcy Clause/Tenth Amendment was precluded by the Commerce Clause case of *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985) (holding that Congress under its Commerce Power may enact legislation arguably impinging on a state's ability to make and enforce its own laws). Appendix at 17a-18a. In focusing only on *Garcia*, the Sixth Circuit ignored this court's holding in *Ashton v. Cameron Water Dist. No. 1*, 298 U.S. 513 (1936) (holding that the Tenth Amendment places justiciable limits on Congress' Article I bankruptcy power).

The Sixth Circuit admitted that its decision impinged on state sovereignty, (Appendix at page 14a), nevertheless, in construing § 506 it refused to apply this court's "plain statement rule" of federalism found in *Gregory v. Ashcroft*, 501 U.S. 452 (1991) (Congress intending to alter the federalism balance with legislation must do so by plain statement). Appendix at 18a.

The Sixth Circuit was troubled by its decision allowing junior-in-priority commercial bondholders to avoid, by manipulation of the Bankruptcy Code, petitioner's senior-in-priority property tax lien. The panel wrote: "We . . . find it anomalous and unwise, from the points of view of federalism and public policy, that the bankruptcy code should favor private creditors over state taxing

authorities." Appendix at 11a. The court also said: "We would prefer to reach a different result, but because of the language of § 506 (b) and *Ron Pair* and the history of additions [to oversecured nonconsensual claims] we are foreclosed." Appendix at 14a.

The Sixth Circuit's basic error, which led to its above-quoted misgivings, is summed up in one statement from that court's opinion:

> "We agree with the county that [this] case is different, because we are dealing with state tax claims, but in the end we do not agree that this difference is significant."

Petitioner submits that the state/federal difference *is* significant, and that significant difference raises important federalism issues that constitute reasons for granting certiorari in this case.

REASONS FOR GRANTING THE PETITION

A. Certiorari Should Be Granted Because The Courts Below And Other Federal Courts Have Erroneously Elevated the Supreme Court's Dictum in Ron Pair into a Problematic, Unintended Holding of Law.

The Sixth Circuit disallowed petitioner's lien/claim under § 506 of the Bankruptcy Code based upon the Sixth Circuit's reading of *United States v. Ron Pair Enters.*, 489 U.S. 235 (1989). In *Ron Pair*, the Internal Revenue Service (the federal government) sought post-petition interest on the IRS' oversecured, pre-petition tax lien. *Ron Pair*, 489 U.S. at 237. The IRS sought no determination as to the

recovery of fees, costs and charges on an oversecured claim in bankruptcy. (*See* 489 U.S. at 237.) The issue appealed and actually decided by this court in *Ron Pair* was, "the narrow statutory issue whether § 506 (b) of the Bankruptcy Code of 1978, 11 U.S.C. § 506 (b), entitles a creditor to receive post-petition interest on a nonconsensual oversecured claim. . . . " *Ron Pair* 489 U.S. at 237. *See also* United States' Petition for Certiorari in *United States, v. Ron Pair Enterprises, Inc.*, No. 87-1043 at p. I (the literal question presented by the petitioner in seeking certiorari was, "Whether § 506 [b] of the bankruptcy code entitles a creditor to receive post-petition interest on an oversecured claim allowed in bankruptcy").

Nevertheless, in writing this court's majority opinion in *Ron Pair*, Justice Blackmun opined generally on § 506 that its,

> . . . natural reading . . . entitles the holder of an over-secured claim to postpetition interest and, in addition, gives one having a secured claim created pursuant to an agreement the right to reasonable fees, costs, and charges provided for in that agreement. Recovery of postpetition interest is unqualified. Recovery of fees, costs and charges, however, is allowed only if they are reasonable and provided for in the agreement under which the claim arose. Therefore, in the absence of an agreement, postpetition interest is the only added recovery available.

Ron Pair, 489 U.S. at 241.

Any actual question or controversy about recovery of "reasonable fees, costs, and charges" was not before this court in *Ron Pair*, and this court has not treated Justice Blackmun's *obiter dictum* on those items as the legal holding of that case. *See Rake v. Wade*, ___ U.S. ___, ___ 113 S. Ct. 2187, 2193-94, 124 L. Ed. 2d 424, 435 n. 12 (1993) ("Ron Pair held that under § 506 [b] a creditor is entitled to post-petition interest on its oversecured claim"); *see also Dewsnup v. Timm*, 502 U.S. 410, 434 (1992) (Scalia and Souter, JJ., dissenting) ("The issue [in *Ron Pair*] was whether § 506 [b] made post-petition interest available even to those oversecured creditors whose liens were nonconsensual").

Unfortunately, lower federal courts around the country in the four years since *Ron Pair* have and are consistently treating the above-quoted *obiter dictum* on § 506 as a determinative legal holding. This issue is most often litigated in cases involving local government (nonfederal) tax liens[2]; *see, e.g., In re Building Technologies Corp.*, 167 Bankr. 853, 859 (Bankr. S.D. Ohio 1994) ("[T]he Supreme Court in *Ron Pair* expressly excluded from recovery anything other than post-petition interest") and *In re Martin*, 106 Bankr. 334, 338 (Bankr. D. Me. 1989) ("In *Ron Pair*, the Supreme Court interpreted the language of § 506 [b] as providing for postpetition interest, but not fees, costs and charges to . . . statutory lienholder[s]").

This misperception of *Ron Pair's* holding now forms the *ratio decidendi* for rulings on nonfederal, property tax liens in the U.S. Circuit Courts of Appeal. *See In re*

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[2] *Ron Pair* involved a *federal* tax lien.

Pointer, 952 F. 2d 82, 89-90 (5th Cir. 1992) (" . . . while the Supreme Court's language in *Ron Pair* may be dicta, it has been adopted by several courts as law [citing, among other cases, *In re Parr Meadows Rac'g Ass'n, Inc.*, 880 F. 2d 1540, 1549 (2d Cir. 1989)]. We agree with the Second Circuit's interpretation of *Ron Pair*, and hold that the [Texas state] taxing units are not entitled to post-petition penalties, fees and costs for the unpaid *ad valorem* taxes as part of their secured claim.") The Sixth Circuit has now joined the Second and Fifth Circuits in this misreading of *Ron Pair*.

This misreading of *Ron Pair* and the resulting misapplication of § 506 to destroy state property tax liens violates the Tenth Amendment and principles of federalism. In passing on the IRS' *federal* claim in *Ron Pair*, this court was not faced with the constitutional tension between the federal bankruptcy power and the sovereignty reserved to the states under the Tenth Amendment.

The constitutional tension of applying the *Ron Pair* dictum to state property tax liens emanates from the fact that the power of taxation is part of state governmental sovereignty "and is inseparable from it." *City of St. Louis v. Wiggins Ferry Co.*, 78 U.S. (11 Wall.) 423, 429, (1870). The taxing power of a state is an attribute of the state's sovereignty. *Nathan v. Louisiana*, 49 U.S. (8 Howard) 73, 82, (1850) and *Hooten v. Carson*, 186 Tenn. 282, 286, 209 S.W. 2d 273, 274 (1948). Indeed the power of taxation is fundamental to the very existence of state government. *State Board of Tax Commissioners of Indiana v. Jackson*, 283 U.S. 527, 537 (1931). The power to tax, with certain exceptions like levying duties on imports and exports, resides

with the states independent of the federal government, and that power, within its true limits may be exercised without restraint from federal authority. *Cox v. Lott*, 79 U.S. (12 Wall.) 204, 212 (1871).

All thirteen original states utilized *ad valorem* property taxes as a means of raising revenue for their governments before the adoption of the United States Constitution and the Tenth Amendment. Acknowledging such, this court in *County of Lane v. Oregon*, 74 U.S. (7 Wall.) 71 (1869), stated that the Tenth Amendment reserved to the several states that power to tax property wholly located within a state's borders. This court said:

> Now, to the existence of the states, themselves necessary to the existence of the United States, the power of taxation is indispensable. It is an essential function of government. It was exercised by the Colonies; and when the Colonies became states, both before and after the formation of the Confederation, it was exercised by the new governments. . . . [Upon adoption of the Constitution certain taxing powers were granted to the National Government and some taxing powers, such as the power to tax exports or imports, were prohibited to the states]. In respect, however, to *property*, business and persons, within their respective limits, [the states'] power of taxation remained and remains entire. (Emphasis added.)

County of Lane v. Oregon, 74 U.S. (7 Wall.) 71, 76-77 (1869).

That reserved sovereignty of the several states necessarily limits Congress' bankruptcy power. *Ashton v. Cameron County Water Improvements Dist. No. 1*, 298 U.S. 513, 528-32 (1936) (holding that the Tenth Amendment forbids

Congress under the Bankruptcy Clause from interfering with the fiscal arrangements of political subdivisions of a state). The Sixth Circuit in misapplying the *Ron Pair dictum* improperly declined to consider the federalism limits on the bankruptcy power recognized by this court in *Ashton*. The Court of Appeals instead, citing *Garcia* as controlling, said that it could not "conclude that the 'national political process' which led to the enactment of the Bankruptcy Code was deficient" Appendix at 17a-18a, and thereupon refused to further consider petitioner's Tenth Amendment rights.

The Sixth Circuit erred by applying *Garcia* too broadly in the context of this dispute. *Garcia*, read correctly, leaves room for consideration of the states' role in our federal union. *See, e.g., C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, ___ U.S. ___, ___, 114 S. Ct. 1677, 1697, 128 L. Ed. 2d 399, 426 (1994) (Souter, J., dissenting) ("States occupy a special and specific position in our constitutional system and the scope of Congress' authority . . . must reflect that position" [citing *Garcia*].) The Sixth Circuit applied *Garcia* too broadly much like the Second Circuit applied *Garcia* too broadly three years ago in *New York v. U.S.*, 942 F. 2d 114, 121 (2nd Cir. 1991) (held: where the political process is not defective, the Tenth Amendment does not bar Congress from legislating in a way impinging on state sovereignty [citing *Garcia*]); *reversed* by this court, *New York v. U.S.*, ___ U.S. ___, 112 S. Ct. 2408, 120 L. Ed. 2d 120 (1992).

Garcia recognizes that Tenth Amendment protection might be available to states in cases where federal action, though not the product of a defective political process, is

more intrusive than that reviewed in *Garcia* or its antecedents.[3] This court in *Garcia* thus stated: "These cases do not require us to identify or define what affirmative limits the constitutional structure might impose on federal action affecting the States under the Commerce Clause. [citation omitted]." *Garcia*, 469 U.S. at 556. *Accord, South Carolina v. Baker*, 485 U.S. 505, 528 (1988) (Scalia, J. concurring in part) and *see also New York v. United States*, ___ U.S. ___, ___, 112 S. Ct. 2408, ___, 120 L. Ed. 2d 120, 151 (1992) ("In determining whether the Tenth Amendment limits the ability of Congress to subject state governments to generally applicable laws, the court has in some cases stated that it will evaluate the strength of federal interests in light of the degree to which such laws would prevent the state from functioning as a sovereign. . . . ")

Whether Congress under the Bankruptcy Clause can constitutionally destroy the state's reserved power to tax local, intrastate property requires more substantive consideration, even under *Garcia*, of what limits the Tenth Amendment places on federal power. Just as "federal taxation of state activities is inherently a threat to state sovereignty," *South Carolina v. Baker*, 485 U.S. 505, 533 (1988), (O'Connor, J. dissenting), congressional destruction of state power to collect local revenues from property taxes threatens state sovereignty. Certiorari should be granted to correct the lower courts' continuing misapplication of the *Ron Pair* dictum in derogation of states' constitutionally reserved power to tax local property.

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[3] *Garcia* did not involve destruction of a state's power to tax intrastate property.

B. Certiorari Should Be Granted Because the Sixth Circuit Erred in Refusing to Follow This Court's "Plain Statement Rule" of Federalism When Applying § 506 to a Local Government Property Tax Lien.

This court has made clear that because states retain their sovereignty under the Tenth Amendment, Congress in enacting legislation affecting the federalism balance must by plain statement make clear that Congress "has in fact faced and intended to bring into issue" any shift in the federalism balance (presumably in favor of federal power) caused by challenged federal legislation, *Gregory v. Ashcroft*, 501 U.S. 452, 461 (1991) and *BFP v. Resolution Trust Corp.*, ___ U.S. ___, ___, 114 S. Ct. 1757, 1764-65, 128 L. Ed. 2d 556, 568-69 (1994) (when Congress under its bankruptcy power intends to invade the traditional domain of states, Congress' intent to do so must be clear).

Instead of following this court's mandated analysis of looking for a plain statement by Congress concerning § 506's intended effect on state property tax liens, the Sixth Circuit treated the "plain statement rule" as "inapposite." Appendix at 18a. Consequently, the Sixth Circuit misapplied § 506 in a way Congress never intended.

This court established long ago in *Swarts v. Hammer*, 194 U.S. 441, 444 (1904) that property in a bankruptcy estate is liable to local taxation just like property outside of bankruptcy. In *California State Bd. of Equalization v. Sierra Summit*, 490 U.S. 844, 853-54 (1989) this court reaffirmed the principle of *Swarts*, and stated that if Congress under the bankruptcy code intended to interfere with a settled state taxation scheme, Congress' intention to do so

must be clearly expressed, *not just left to be judicially inferred.*

As this Court has said plainly, " . . . [W]e [the Court] must be absolutely certain that Congress intended such an exercise [to shift the federal/state balance]. [T]o give the state-displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure for lawmaking on which *Garcia* relied to protect states' interests." (emphasis in original) *Gregory v. Ashcroft*, 501 U.S. at 464. *Accord Allied-Bruce Terminix Cos. Inc. v. Dobson*, ___ U.S. ___, ___, 115 S. Ct. 834, 848, 130 L. Ed. 2d 753, 775 (1995) (Thomas, J., dissenting) ("To the extent that federal statutes are ambiguous, we do not read them to displace state law.")

As to § 506 itself, this court has very recently said that, "Section 506 of the Bankruptcy Code and its relationship to other provisions of that Code do embrace some ambiguities. . . ." *Dewsnup v. Timm*, 502 U.S. 410, 416 (1992). The seven-member *Dewsnup* majority said that several troubling hypothetical applications of § 506 "come to mind" and must "await their legal resolution on another day." *Dewsnup*, 502 U.S. at 416-17. This petition for certiorari squarely presents the effect of one of those ambiguities: the misapplication of § 506 (b) and (d) to destroy in part a state property tax lien in violation of the Tenth Amendment and federalism principles.

Despite showings by petitioner, the Sixth Circuit refused to review § 506's enacting history for a clear statement of Congress' intent as to § 506's effect on the federalism balance. Instead the Sixth Circuit independently applied the statute to destroy in part petitioner's

lien, and in so doing, the Court of Appeals impermissably departed from this Court's recent federalism teachings in *California State Bd. of Equalization, Gregory v. Ashcroft*, and *BFP v. Resolution Trust Corp.* This Court should grant certiorari to correct the lower court's failure to follow this Court's precedents in this important area of construing and applying statutes impacting federalism.

C. Certiorari Should Be Granted Because the Issues Involved in This Case Have Nationwide Significance.

This case merits this court's review because, as the Sixth Circuit pointed out, "[T]he legal questions presented are significant [and] frequently repeated in bankruptcy litigation. . . . "[4] Appendix at 4a. Although this present case arose in a Chapter 11 proceeding, 11 U.S.C. § 103 (a) (1988) makes § 506 applicable also in Chapter 7 (liquidation), Chapter 12 (family farm adjustment of debts) and Chapter 13 (wage earner plans). Unless this court grants certiorari to correct the decision below, debtors (and junior co-creditors as in this case) in all those types of bankruptcies will continue to use § 506 against counties and local governments. A definitive

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[4] *See e.g.*, Hill, *Treatment of Interest and Penalties on Property Tax Claims in Chapter 11 Bankruptcy Cases*, 1994-1995 Annual Survey of Bankruptcy Law 177 (1994) (collecting between fifty and one hundred reported lower court decisions in Chapter 11 cases alone from all over the country dealing in part with whether penalties are allowable as part of property tax claims in bankruptcy.)

national rule is needed on this recurring issue that has the potential to arise in *every* bankruptcy filed nationwide where delinquent property taxes owed by the bankrupt are secured by a single, statutory, "nonconsensual" lien that also secures related penalties, fees and costs.[5]

This misapplication of § 506 comes at one of the worst possible times for state and local governments. Shifting of additional fiscal burdens/responsibilities onto state and local governments makes every locally-raised

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[5] Counsel for the petitioner submits that at least the following twenty-five American states have such "nonconsensual" liens: Arizona: Ariz. Rev. Stat. Ann. § 42-312 (1991); Arkansas: Ark. Code Ann. § 26-34-101 (Michie 1992); California: Cal. Gov't Code § 43001 (West 1983); Colorado: Colo. Rev. Stat. Ann. § 39-1-107 (West 1990 & Supp. 1994); Connecticut: Conn. Gen. Stat. Ann. § 12-172 (West 1993); Indiana: Ind. Code Ann. § 6-1.1-22-13 (West Supp. 1994); Kansas: Kan. Stat. Ann. § 79-1804 (1989); Kentucky: Ky. Rev. Stat. Ann. § 134.420 (Michie/Dobbs-Merrill 1991); Massachusetts: Mass. Gen. Laws Ann. ch. 60, § 37 (West 1988); Michigan: Mich. Comp. Laws Ann. § 211.40 (West 1986); Missouri: Mo. Ann. Stat. § 137.085 (Vernon 1988); Nevada: Nev. Rev. Stat. Ann. § 361.450 (Michie 1993); New Jersey: N.J. Stat. Ann. § 54:5-6 (West Supp. 1994); New Mexico: N.M. Stat. Ann. § 7-38-48 (Michie Supp. 1994); North Carolina: N.C. Gen. Stat. § 105-355 (Supp. 1994); North Dakota: N.D. Cent. Code § 57-02-40 (1993); Ohio: Ohio Rev. Code Ann. § 323.11 (Anderson 1994); Oklahoma: Okla. Stat. Ann. tit. 68, § 234 (West 1992); Oregon: Ore. Rev. Stat. § 311.405 (1993); South Carolina: S.C. Code Ann. § 12-49-10 (Law. Co-op. 1976); Tennessee: Tenn. Code Ann. § 67-5-2101 (1994); Texas: Tex. Tax Code Ann. § 32.01 (West Supp. 1995); Virginia: Va. Code Ann. § 58.1-3340 (Michie Supp. 1994); Washington: Wash. Rev. Code Ann. § 84.60.010 (West 1991); Wisconsin: Wis. Stat. Ann. § 74.01 (West 1989).

cent of revenue crucial[6] and magnifies the timeliness of this Court's review of this problem area of bankruptcy/federalism law.

For systemic reasons, very few cases on this particular issue will ever reach this court. Disallowed penalty, interest, costs and charges will usually involve too little money to monetarily warrant a local government carrying a case this far. Petitioner's case provides an available vehicle for this Court to correct this bankruptcy/federalism problem.

The adjudicative facts in this case are not disputed. This case is procedurally and jurisdictionally in a correct posture before this Court, and this case involves only pure, well-defined questions of federal law. Petitioner submits that this case presents a timely, apt vehicle for this Court's consideration of an important, recurring, wrongly-decided federalism issue adversely affecting American local governments.

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[6] Property taxes provide seventy-five percent (75%) of all local government tax revenues. Petersen, *Local Government's Fiscal Recovery: Don't Count on Property Taxes*, Governing: The Magazine of States and Localities, February 1993 at 58.

CONCLUSION

This court should grant a writ of certiorari to the Sixth Circuit.

Respectfully submitted,

STEPHEN P. JORDAN
YOST AND ROBERTSON
P.O. Box 1544
Franklin, TN 37065-1544
(615) 790-9678
Counsel for Petitioner

APPENDIX

Nos. 93-5484/5609

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

In re: BRENTWOOD OUTPATIENT, LTD., d/b/a BRENTWOOD OUTPATIENT MEDICAL CENTER, *Debtor.*	)	ON APPEAL from the United States District Court for the Middle District of Tennessee
BONDHOLDER COMMITTEE, *Appellee/ Cross-Appellant,* v. WILLIAMSON COUNTY, TENNESSEE, *Appellant/ Cross-Appellee.*	)	

Decided and Filed December 13, 1994

Before: MERRITT, Chief Judge; and MILBURN and SILER, Circuit Judges.

MERRITT, Chief Judge. Several questions about the handling of secured interests in bankruptcy and a constitutional question are presented in this Chapter 11 appeal and cross-appeal involving postpetition additions to local property taxes (penalties, costs and attorneys fees) which became due under Tennessee law after the debtor in possession failed to pay local property taxes. The primary

questions the parties raise are issues of statutory construction under § 506(b) of the Bankruptcy Code concerning the allowance of claims against property which is more valuable than the secured claims against it. We must decide whether in a Chapter 11 proceeding a local government may collect statutory (1) costs and attorneys' fees and (2) penalties of 1/2% per month which accrue on delinquent property taxes after the filing of the bankruptcy petition; and (3) whether any allowable penalties, costs, and fees are due up to the time the delinquent property taxes are paid or only up to the effective date of the Chapter 11 plan. Plaintiff also raises a Tenth Amendment issue, arguing that any interference with its collection of these statutory additions to tax violates the State's reserved powers to tax local property.

I.

Brentwood Outpatient, Ltd., a medical clinic near Nashville, is a voluntary Chapter 11 debtor. The clinic, which owned a three-story, 60,000-square foot, $4 million medical facility on 2.7 acres, filed its petition under 11 U.S.C. § 301 in August 1989. The building was financed through the issuance of local industrial revenue bonds owned by investors represented in this case by the "Official Bondholders Committee." Property taxes on the building for tax year 1989 became due and payable to Williamson County in October 1989, two months after the petition was filed. Under Tennessee law the taxes became delinquent on March 1, 1990, after which the county was entitled to collect interest at 1% per month and penalty of

1/2% per month,[1] as well as costs and lawyers' fees.[2] The parties and the courts below agree that all these taxes and additions to taxes were secured by a statutory first-in-priority lien on the medical facility property.[3]

The County asserted a claim for $29,961.12 in base tax, $4,494.17 in statutory interest, $2,247.08 in statutory penalties, $2,996.11 in attorney's fees, and roughly $1,900 in court costs. The value of the real property in question

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[1] Tenn. Code Ann. § 67-5-2010 (1989) provides that "[t]o the amount of tax due and payable, a penalty of one-half of one percent . . . and interest of one percent . . . shall be added on March 1, following the tax due date and on the first day of each succeeding month[.]"

[2] Tenn. Code Ann. § 67-5-2101 (1989) provides that "[t]he taxes assessed by the State of Tennessee, a county, . . . or other local governmental entity, upon any property of whatever kind, and all penalties, interests, and costs accruing thereon, shall become and remain a first lien upon such property from January 1 of the year for which such taxes are assessed." The statutory provision allowing for the recovery of attorney's fees in back tax matters is Tenn. Code Ann. § 67-5-2410 (1989). The provisions governing court costs in back tax matters are Tenn. Code Ann. §§ 67-5-2421 (1989), 8-21-601 (1988), and 8-21-701(55) (Supp. 1992).

[3] As of the date of filing of the petition, the taxes at issue were neither due nor delinquent. The County maintains that the taxes "relate back" to a time before the petition was filed, see Tenn. Code Ann. § 67-5-2101 (1989), *supra* note 2, but we think it possible that the automatic stay provision of § 362(4) might have prevented the lien from attaching. This provision provides that "a petition filed under section 301 . . . operates as a stay, applicable to all entities, of . . . any act to create, perfect, or enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4). However, we need not inquire further into this issue as the parties agree that the County has a tax lien.

exceeded the total tax claim, making the claim "oversecured." A plan of reorganization proposed by the Bondholders Committee was confirmed on May 14, 1991, effective June 1, 1991. The plan classified the County as a "Class 3" creditor and provided that its claims "shall be paid in cash, in full, on the effective date of the plan." Fourth Amended and Restated Plan, articles II and IV. After confirmation of the plan, the Bondholders Committee paid the base tax plus prepetition and postpetition interest but objected to payment of the statutory penalties, attorneys' fees, and costs. So the amount of money at issue is small, but the legal questions presented are significant, frequently repeated in bankruptcy litigation, and unsettled in the Sixth Circuit.

On December 18, 1991, the bankruptcy court, Judge Lundin, in a thoughtful opinion, allowed the payment of delinquent penalties against the objection of the Bondholders Committee but disallowed the payment of costs and fees; held that the County's entitlement to penalties would run only up to the effective date of the reorganization plan, not to the date of payment of the taxes; and allowed postpetition interest up to the date of payment. *In re Brentwood Outpatient, Ltd.*, 134 B.R. 267 (Bankr. M.D. Tenn. 1991). (More accurately, the bankruptcy court held that postpetition interest ceased to accrue on the effective date of the plan but that "[a]fter the effective date, Williamson County is entitled to interest through the date of payment to insure payment of the present value of its allowed secured claim." *Id.* at 274.) On March 17, 1993, the District Court, Judge Wiseman, again in a well-reasoned opinion, affirmed these rulings. *In re Brentwood Outpatient, Ltd.*, 152 B.R. 727 (M.D. Tenn. 1993). In its

appeal, the County seeks priority for its statutory costs and fees and seeks to have the penalties accrue up to the date of payment. The Bondholders Committee seeks a ruling that tax penalties which accrue postpetition should not be allowed as a valid claim in bankruptcy.

II.

The parties and the courts below have all focused on § 506(b) of Chapter 11 as the most important provision governing the validity of the tax claims in this case. That section provides:

> To the extent that *an allowed secured claim* is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges *provided for under the agreement under which such claim arose.*

11 U.S.C. § 506(b) (emphasis added). Because this section on its face seems to give instructions pertaining only to consensual claims (claims "under the agreement"), we initially found it difficult to accept that it was dispositive in the case of a nonconsensual lien such as the instant tax claim. (A "consensual" claim is one arising from a negotiated agreement, such as a security agreement giving the creditor an interest in specified collateral. A "nonconsensual" claim is one arising without a specific agreement, such as a tax claim arising by statute or a judgment lien resulting from litigation.) If § 506(b) controls this case, the result is that a commercial creditor is placed in a better position for the purposes of bankruptcy than a state in its taxing authority. This seems incongruous to us because

under the construction given by the courts below a bank or other lender which enters into a security agreement can collect its costs and fees as itemized in the agreement, but a state entitled by statute to collect costs and fees is denied them because they arise by operation of law and not under an agreement. Both the policy and the result clearly seem unwise. However, a historical inquiry into this area of bankruptcy law convinces us that such is in fact the case and that like the courts below we are constrained to so hold. The historical development of bankruptcy law overcomes what we would consider to be sound policy.

Early in this century Justice Holmes wrote for a unanimous Supreme Court that the United States had adopted, along with the basic English bankruptcy system, the "English rule" that even secured claims in bankruptcy were not entitled to postpetition interest. *Sexton v. Dreyfus,* 219 U.S. 339, 343-44 (1911). The English rule was thought to serve the interest of providing a "certain date" for winding up the affairs of the bankrupt and distributing the estate. *Id. Sexton* did not address the treatment of secured *tax* claims in bankruptcy, and our bankruptcy regime has of course been amended several times since then. In a case at midcentury involving a state tax claim, however, the Court found that "[t]he long-standing rule against post-bankruptcy interest [still] appears implicit in our current Bankruptcy Act." *New York v. Saper,* 336 U.S. 328, 332 (1949). While taxes received preferred treatment under the 1898 Bankruptcy Act, *see Swarts v. Hammer,* 194 U.S. 441, 444 (1904); *Michigan v. Michigan Trust Co.,* 286 U.S. 334, 344 (1932), Justice Jackson wrote in 1949 in *Saper* that "by the 1926 amendment and the [1938] Chandler

Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest." *Saper*, 336 U.S. at 337. "Our present statute contains no provision expressly repudiating . . . the rule stopping interest [upon filing, which has] been followed for more than a century and a half," *id.* at 330, and "the statute as amended did not contemplate any exception in favor of tax claims." *Id.* at 338. *See also Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946) ("[t]he general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings").

Aside from concerns about the efficient administration of bankruptcy, the basic theory behind the "English rule" was that allowing postpetition additions penalized either the debtor, whose "fresh start" was impeded, or the other creditors, particularly unsecured creditors who could cite neither an agreement nor a statute as a basis on which to claim additions. As the Supreme Court has said, secured claims accruing postpetition interest would continue to "absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debts owed by the estate." *Nicholas v. United States*, 384 U.S. 678, 683-84 (1966); *see also Vanston*, 329 U.S. at 163-64.

But cases and life are more complex than simple rules of this kind, and so caselaw twists and turns and makes exceptions. In the decades leading up to the comprehensive Bankruptcy Reform Act of 1978, many courts developed an exception to allow creditors with consensual oversecured liens to collect postpetition interest, fees, and costs, to the extent provided in the security agreement.

The typical justification was that these creditors had bargained for these rights, giving consideration and identifying specific collateral from which the additional payments should be made, and that courts should protect their expectations. *See, e.g., United States v. Harrington,* 269 F.2d 719, 724 (4th Cir. 1959). But this was an *exception.* unsecured creditors continued to have no such entitlement, and even creditors with oversecured liens arising not by agreement (such as tax and judgment liens) were not generally allowed postpetition additions because they had not bargained for them and any postpetition sums they could collect would come at the cost of the unsecured creditors. *See In re Boston & Maine Corp.,* 719 F.2d 493, 497 (1st Cir. 1983), *cert. denied,* 466 U.S. 938 (1984). Postpetition interest on nonconsensual claims was seen as an "unbargained-for windfall at the expense of the general unsecured creditors of the debtor." Charles Jordan Tabb and Robert M. Lawless, "Of Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court," 42 Syracuse L. Rev. 823, 845 (1991); *see also* Jeffrey H. Paravano, "Postpetition Interest on Oversecured Tax Liens – Abandonment of the 'Nonconsensual' Distinction in Bankruptcy Proceedings: *United States v. Ron Pair Enters.,*" 43 Tax Law. 475 (1990).

The Courts of Appeals which addressed this issue prior to the enactment of the 1978 Code all followed this rule. *See In re Kerber Packing Co.,* 276 F.2d 245, 246-48 (7th cir. 1960); *Harrington,* 269 F.2d at 721-24; *United States v. Bass,* 271 F.2d 129, 130-32 (9th Cir. 1959); *United States v. Mighell,* 273 F.2d 682, 684 (10th Cir. 1959); *see also Boston and Maine,* 719 F.2d at 496-98; for a possible counterexample, *see Berryhill v. Gerstel,* 196 F.2d 304 (5th Cir. 1952). As

late as 1988 Collier's endorsed what it characterized as mainstream pre-1978 Code practice to deny postpetition interest on nonconsensual oversecured claims. 3 Collier on Bankruptcy ¶ 506.05 and n.5b (15th ed. 1988). Early decisions under the 1978 Code were mixed, with some awarding postpetition interest on nonconsensual liens, *see Best Repair Co. v. United States*, 789 F.2d 1080, 1082 (4th Cir. 1986), and others following the traditional rule, *see United States v. Ron Pair Enters.*, 828 F.2d 367, 370-73 (6th Cir. 1987), *rev'd*, 489 U.S. 235 (1989); *In re Newbury Cafe*, 841 F.2d 20, 22 (1st Cir. 1988), *vacated*, 489 U.S. 1049 (1989); *Boston & Maine*, 719 F.2d at 495-98. However, it is notable that courts on both sides of this question typically began their analysis with the traditional rule and then found that Congress in enacting § 506(b) either codified by implication that traditional denial of postpetition additions to nonconsensual claims or modified that rule to the extent of allowing postpetition interest only.

The Supreme Court has recently settled this difference of opinion among the circuits. In *United States v. Ron Pair Enters.*, 489 U.S. 235 (1989), the government sought interest on its tax claim. The Court found that § 506(b) provides for postpetition interest on oversecured claims whether they arise by operation of law or under an agreement, but allows postpetition fees and costs only to consensual oversecured lienholders whose claims arise by agreement. *Id.* at 241-42. Justice Blackmun wrote for the majority that

> The natural reading of [§ 506(b)] entitles the holder of an oversecured claim to postpetition interest and, in addition, gives one having a secured claim created pursuant to an agreement

> the right to reasonable fees, costs, and charges provided for in that agreement. Recovery of postpetition interest is unqualified. Recovery of fees, costs, and charges, however, is allowed only if they are reasonable and provided for in the agreement under which the claim arose. *Therefore, in the absence of an agreement, postpetition interest is the only added recovery available.*

Id. at 241 (emphasis added). As a result, the Court allowed the United States to collect unpaid withholding and Social Security taxes as well as postpetition interest thereon. The *Ron Pair* Court was closely divided, with the four dissenting justices finding that § 506(b) codified the traditional rule denying postppetition interest on nonconsensual claims. *Id.* at 253-54. All the justices, however, apparently accepted the majority's basic premise that neither consensual nor nonconsensual lienholders are entitled to postpetition additions except to the extent that § 506(b) provides – "in the absence of an agreement, postpetition interest is the only added recovery available." *Id.* at 241. This comports with the traditional understanding as described above, as well as with other sections of the Code which embody the general rule that creditors normally are not entitled to postpetition additions.[4]

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[4] For example, 11 U.S.C. § 502(b)(2) provides that where a claim is objected to the court "shall determine the amount of such claim . . . as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that . . . such claim is for unmatured interest[.]" 11 U.S.C. § 503 allows payment of taxes and penalties *incurred* postpetition by the bankruptcy estate, as administrative claims.

Williamson County protests that *Ron Pair* does not control the instant case because it involves the treatment of a *federal* tax claim in bankruptcy, a situation that does not implicate the concerns of federalism present in the instant case. We agree with the County that our case is different, because we are dealing with state tax claims, but in the end we do not agree that this difference is significant. Only if there were no coherent rule as to postpetition additions to nonconsensual claims could we say that *Ron Pair's* holding was limited to federal tax claims. Because we are persuaded that the 1978 Code follows pre-Code law in its general denial of postpetition additions to tax claims regardless of their origin, we find that *Ron Pair* applies to this state tax claim.

We still find it anomalous and unwise, from the points of view of federalism and public policy, that the Bankruptcy Code should favor private creditors over state taxing authorities. We are nevertheless persuaded that § 506(b), when read in historical context, does control this case because it sets out the only exceptions to the general rule disallowing postpetition additions. Since the Supreme Court has ruled decisively on the meaning of § 506(b), it is now clear to us that the bankruptcy court was correct in allowing the County to recover postpetition interest but concluding that "*Ron Pair* requires disallowance of Williamson County's claim for post-petition fees and costs because Williamson County's claim arose by operation of law and not by agreement." *Brentwood Outpatient*, 134 B.R. at 270.

For similar reasons, however, we find that the courts below erred in allowing the County's claim for statutory penalties which had not accrued at the date of filing of

the bankruptcy petition. In allowing the penalty, the bankruptcy court reasoned that § 506(b) does not include, exclude, or even mention penalties; that § 724(a) of the Code makes such penalties voidable in Chapter 7 cases but that the Code is silent as to Chapter 11 cases; and that the legislative history makes it clear that a penalty "lien is made voidable rather than void in chapter 7, in order to permit the lien to be revived if the case is converted to chapter 11, under which penalty liens are not voidable." *Brentwood Outpatient*, 134 B.R. at 271 (quoting S.Rep. No. 989, 95th Cong., 2d Sess. 96, *reprinted in* [1978] U.S. Code Cong. & Admin. News 5787, 5882). The Bondholders Committee takes issue with this holding primarily on the ground that it is inconsistent with the decisions of two of our sister circuits that penalties fall within the category of "fees, costs, or charges" disallowed by § 506(b) unless the claim arises under a consensual agreement. *City of Farmers Branch v. Pointer (In re Pointer)*, 952 F.2d 82, 89 (5th Cir.), *cert. denied*, 112 S.Ct. 3035 (1992); and *In re Parr Meadows Racing Ass'n*, 880 F.2d 1540, 1549 (2d Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990).

The bankruptcy court's analysis suggests that Congress may have intended to allow claims for tax penalties in Chapter 11 but not in Chapter 7 because penalties would be paid in the former by the debtor but in the latter by the creditors. The court carefully distinguished *Parr Meadows* as a Chapter 7 case, and the district court noted that *Pointer*, a Chapter 11 case, followed *Parr Meadows* without noticing this distinction between Chapter 7 and Chapter 11 policy. *See generally Brentwood Outpatient*, 134 B.R. at 270-73; 152 B.R. at 731-32. However the

bankruptcy court also observed that its "interpretation . . . leads to one odd outcome.":

> The Code allows penalties to the holder of an oversecured, nonconsensual tax claim in a Chapter 11 case, but § 506(b) and *Ron Pair* preclude allowance of post-petition fees, costs and charges. Arguably, fees, costs and charges are more in the nature of "compensation" than are penalties. Elsewhere, the Code demonstrates Congressional intent to treat compensatory claims by taxing authorities more favorably than non-compensatory claims.

Brentwood Outpatient, 134 B.R. at 273.

The Bankruptcy court suggested that § 506(b) "does not address penalties," *Id.* at 273, and concluded from this silence that the section does not govern the allowability of penalties. The court therefore ruled that the penalties were an allowable claim. Because of our discussion above, in which we found that no postpetition additions to claims are allowable in Chapter 11 cases except as provided by § 506(b), we draw the opposite conclusion – that penalties which accrue postpetition are not allowed to a nonconsensual oversecured claim in bankruptcy.[5] We therefore,

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[5] We need not decide today whether a *consensual* oversecured creditor would have priority for postpetition penalties provided for in a security agreement – i.e., whether "penalties" are in the category of "fees, costs, or charges" created by § 506(b). *See* Judge Lundin's thorough discussion, *Brentwood Outpatient*, 134 B.R. at 272-73. It may be that Congress did not allow for penalties in § 506(b) precisely because they are punitive rather than compensatory.

reverse that portion of the decision below allowing postpetition penalties and note that this result, by differentiating between pre- and postpetition penalties, eliminates the "odd outcome" discussed above. Like consensual lienholders, nonconsensual oversecured lienholders are entitled to interest, penalties, fees, and costs which accrue *pre*petition; but the only allowable *post*petition addition for nonconsensual lienholders is interest, which is a compensatory claim. We would prefer to reach a different result, but because of the language of § 506(b) and *Ron Pair* and the history of additions we are foreclosed.

Because we hold that no penalties were allowable, the County's contention that penalties should accrue to the date of payment is moot.

III.

Our holding impinges on the taxing power of the State of Tennessee, and the bankruptcy court's confirmation of the reorganization plan further impinges on that power by causing the transfer of the real property under a trust indenture, free and clear of the County's lien. Indeed, the Bankruptcy Code generally intends the avoidance of such liens, providing that "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor." 11 U.S.C. § 1141(c). The County protests that any disallowance of its statutory tax additions

violates the Tenth Amendment[6] by interfering with the state's reserved powers to assess, levy, and collect taxes on local property; and that its lien and *in rem* rights against the property outside bankruptcy for unpaid penalty, fees, and costs should survive these bankruptcy proceedings, notwithstanding the discharge of the debtor's personal liability and the disallowance of these charges as part of the debtor's reorganization, and that any destruction of these liens by operation of the Bankruptcy Code would violate the Tenth Amendment.

The County is correct that the sovereign powers of the State of Tennessee should not lightly be construed to be subordinated to the federal bankruptcy power, but the constitutionality of the orders below and of our own holding today is clear. No one in this case disputes the allowability of the base tax and statutory interest as claims in a Chapter 11 proceeding, only the allowability of other statutory additions. Article I of the United States Constitution gives Congress the power to regulate bankruptcy.[7] While this power is of course subject to fundamental constitutional restraints, *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589, 602 (1935) (Fifth Amendment), we know of no precedent for the proposition that the Tenth Amendment forbids the relatively minor impact on the states' powers of taxation which

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[6] The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X.

[7] "The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States[.]" U.S. Const. art. I, § 8, cl. 4.

results from Congress's decision that the states *as creditors* are subject to the same bankruptcy regime as all other nonconsensual creditors making claims upon a bankruptcy estate. There would be a constitutional question were Congress to legislate that a bankruptcy court has the power to void all state tax claims once a debtor files for bankruptcy, but this case presents no such question.

As discussed above, the Supreme Court found half a century ago that Congress intended to subject all creditors including states to the general presumption against postpetition additions, *New York v. Saper*, 336 U.S. at 337, and the Court apparently had no qualms about the constitutionality of this rule as applied to the states as tax creditors. The need to wind up a bankrupt's estate in an efficient and timely manner with fair treatment of all classes of creditors is compelling, and both the traditional rule against postpetition additions and its modification by § 506(b) serve that need. Similarly, the stated goal of permitting the debtor to reorganize and resume a productive role in the economy is served by the provision that once the bankruptcy court approves a reorganization plan the property dealt with will normally be free and clear of existing liens. The Supremacy Clause[8] mandates that these policy decisions by Congress pursuant to its bankruptcy power displace the normal operation of Tennessee's statutory provisions for additions to local property taxes to the extent that the latter command contrary results. As the Supreme Court has explained, "[i]f a state

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[8] This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land[.]" U.S. Const. art. VI.

desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated." *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933). A bankruptcy court's lack of power to address state tax liens would "seriously impair the power of the court to administer the estate and adversely affect the power of . . . the court to promulgate a reorganization plan." *Gardner v. New Jersey*, 329 U.S. 565, 577 (1947).

We also agree with the district court that under *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528 (1985),

> a court may impose a substantive restraint on Congress's establishment of bankruptcy laws, such as holding that extinguishment of tax lien costs and fees under Section 506(b) is unconstitutional, only if the court were satisfied that the interests of local and state government in their tax revenues inherently could not have been represented in Congress or "the national political process" and that such a holding compensated for the process[.]

Brentwood Outpatient, 152 B.R. at 730. As the District Court noted § 506(b) does not discriminate against state liens relative to either federal liens or other nonconsensual liens such as judgments arising from private litigation. The federal and state taxing interests implicated by those parts of the Bankruptcy Code at issue in this case are therefore identical, *id.* at 731, and as a result we cannot conclude that the "national political process" which led to the enactment of the Bankruptcy Code was

deficient in its representation of the states' interests. *See Garcia*, 469 U.S. at 554. Although *Garcia* concerned the interstate commerce power, its analysis applies equally to the bankruptcy power and compels the conclusion that no judicial action taken in this case violates the Tenth Amendment.

Even conceding Congress's power to regulate bankruptcy, the County argues that the "plain statement rule" prevents the decision we have reached. Because states retain their sovereignty under the Tenth Amendment, Congress in enacting legislation, affecting the balance in our federal system between the national and state governments must by plain statement make clear that it has duly deliberated the issue and fully intended to reach that result. " '[T]o give the state-displacing weight of federal law to mere congressional *ambiguity* would evade the very procedure for lawmaking on which *Garcia* relied to protect states' interests.' " *Gregory v. Ashcroft*, 501 U.S. 452, 464 (1991) (quoting L. Tribe, American Constitutional Law § 6-25 at 480 (2d ed. 1988)). However, contrary to the County's arguments, neither § 506(b) nor the provision for destruction of liens represents a recent congressional attempt to invade the states' reserved powers; in fact, § 506(b) *relaxes* the traditional presumption as to the states by allowing them to collect postpetition interest. The County's argument that § 506(b) does not evince a sufficiently clear congressional intent to encroach on states' reserved powers is therefore inapposite.

The County's reliance in this context on *New York v. United States*, 112 S.Ct. 2408 (1992), is misplaced. In that case, the Supreme Court invalidated that portion of a

federal law requiring states to accept ownership of hazardous waste because in our federal system Congress has no power to mandate specific behavior by a state. *Id.* at 2435. The instant case is very different because the Code sections at issue mandate no action; instead, they block the full operation of a state law in the context of a *federal* procedure. The federal bankruptcy power may constitutionally impinge on the state taxing power just as the federal commerce power prevents the states from enacting discriminatory taxes on out-of-state businesses. Moreover, in *New York* the Court took as well established "the authority of Congress to subject state governments to generally applicable laws." *Id.* at 2420. In the instant case, to appropriate Justice Blackmun's words in *Garcia*, "we perceive nothing in the . . . requirements of the [Bankruptcy Code], as applied to [the County], that is destructive of state sovereignty or violative of any constitutional provision. [The County] faces nothing more than the same [rules of bankruptcy] that hundreds of thousands of other [creditors], public as well as private, have to meet." 469 U.S. at 554.

Therefore, for the reasons stated above, the judgment of the district court is AFFIRMED in part and REVERSED in part and the cause is REMANDED to the district court with instructions to remand to the bankruptcy court for further proceedings consistent with this opinion.

IN RE BRENTWOOD OUTPATIENT, LTD., d/b/a Brentwood Outpatient Medical Center, Debtor.

No. 3:92-0330.

United States District Court,
M.D. Tennessee,
Nashville Division.

March 17, 1993.

MEMORANDUM

WISEMAN, District Judge.

I.

The Debtor, Brentwood Outpatient, Ltd., ["Debtor"] filed a Chapter 11 petition in August, 1989. Williamson County ["County"] asserted a secured claim in January, 1990, for unpaid 1989 real property taxes on a three story medical facility the Debtor owned in Brentwood, Tennessee ["the property"]. In May, 1991, the County asserted a secured claim in the amount of $41,543.60 for 1989 real property taxes. Of this amount, the County requested $29,961.12 for the base tax, $4494.17 for interest, $2247.08 for penalties, $2996.11 for attorney's fees, and $1845.12 for court costs. The interest, penalties, fees, and costs had accrued post-petition since February 28, 1990. The value of the property exceeded the amount of taxes in dispute.

On May 31, 1991, the Debtor's Bondholder Committee ["Committee"] objected to the County's claim, arguing that the penalties, fees, and costs asserted by the County to be due and payable were not authorized under 11 U.S.C. § 506(b). The Committee did not object to the County's claim for base taxes and interest which had

accrued to the effective date of the confirmed plan, June 1, 1991.

By order entered December 18, 1991, the U.S. Bankruptcy Court, Judge Lundin, allowed the County's claim in part and denied it in part. *In re Brentwood Outpatient Ltd.*, 134 B.R. 267 (Bankr. M.D.Tenn.1991). Judge Lundin allowed the County's secured claim to include penalties and the stipulated interest, but denied costs and attorneys' fees. *Brentwood Outpatient Ltd.*, 134 B.R. at 270, 273. Judge Lundin also held that post-petition interest ceased to accrue on the effective date of the plan. *Brentwood Outpatient Ltd.*, 134 B.R. at 274. On March 20, 1992, the Bankruptcy Court denied the County's motion to alter or amend the Court's order. The County appealed to this Court and the Committee cross-appealed.

This Court has jurisdiction over this bankruptcy appeal pursuant to 28 U.S.C.A. § 158(a) (West. Supp.1992).

II.

The issues presented raise only questions of law which are reviewable *de novo* by this Court. *BancBoston Mortgage Corp. v. Ledford*, 127 B.R. 175, 177 (M.D.Tenn.1991).

III.

A. *Constitutionality of denying the County's costs and fees claims.*

The County argues that Congress did not intend in 11 U.S.C. Section 506 to destroy a state's sovereign power to tax by destroying a portion of the state's tax lien in bankruptcy. The County further argues that if Congress did so intend, that act of destroying a state's sovereign power to tax real property located within its borders is unconstitutional because the Tenth Amendment to the United States Constitution reserves the power to tax real property to the states. *See* Brief of Williamson County, Tennessee at 6 ["Appellant's Brief"]. The County asserts that "any construction of 11 U.S.C. Section 506 that would somehow destroy the county's tax lien for post-petition attorney's fees and costs would be antithetical to the state's sovereign power to tax and would infringe on the Tenth Amendment." *Id.* at 12.

The Tenth Amendment provides: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X. The Constitution does, of course, grant to Congress the power to establish bankruptcy laws. Article I, Section Eight of the Constitution provides: "Congress shall have Power . . . to establish . . . uniform laws on the subject of Bankruptcies throughout the United States. . . . " U.S. CONST. art. I, § 8, cl. 4. Of course, this power is not unfettered. *See, e.g., Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935) (holding that Congress's power to establish bankruptcy

law is subject to the prohibitions of the Fifth Amendment). The question raised in this appeal is whether the Tenth Amendment imposes any prohibitions on the bankruptcy power.

The County argues that the power of taxation is fundamental to the very existence of state government. Appellant's Brief at 9 (citing *State Bd. of Tax Comm'rs of Ind. v. Jackson*, 283 U.S. 527, 537, 51 S.Ct. 540, 543, 75 L.Ed. 1248, 1255-56 (1931)). The County also asserts that the Supreme Court has held that "a state's internal fiscal affairs are 'not subject to control or interference by the national government, unless the right to do so is definitely accorded by the Federal Constitution.' " Appellant's Brief at 14 (quoting *Ashton v. Cameron County Water Improvement Dist. No. One*, 298 U.S. 513, 528, 56 S.Ct. 892, 895, 80 L.Ed. 1309, 1312-13 (1936)). The County further contends that a county's tax lien secures not only the tax, interest and penalty, but also costs and fees. Appellant's Brief at 9. From these propositions, the County concludes that any attempt by Congress via Section 506(b)[1] of the Bankruptcy Code to destroy the County's power to obtain costs and fees arising from a nonconsensual lien based

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[1] Section 506(b) of the Bankruptcy Code provides:

> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C.A. § 506(b) (West Supp.1992).

upon unpaid property taxes is a violation of the Tenth Amendment.

The County's arguments are, in the Court's opinion, without merit. Congress, through its bankruptcy power, may circumvent a state's power to tax implicit in the Tenth Amendment. *Matter of CCA Partnership*, 70 B.R. 696 (Bankr.D.Del.1987) *aff'd* 72 B.R. 765, *aff'd* 833 F.2d 303 (3d Cir.1987) (without opinion). Indeed, the Bankruptcy Court for the Middle District of Tennessee has stated:

> [T]he Supreme Court has recognized as a well-settled principle that a state's power to assess and collect state taxes must submit to the federal rules and regulations controlling the administration of the bankruptcy estate. *See, e.g., Gardner v. New Jersey*, 329 U.S. 565, 575-579, 67 S.Ct. 467, 472-474, 91 L.Ed. 504 [515-516] (1947); *New York v. Irving Trust Co.*, 288 U.S. 329, 331-333, 53 S.Ct. 389, 390-391, 77 L.Ed. 815 [817-818] (1933). . . . As the Supreme Court explained in *New York v. Irving Trust Co.*, 288 U.S. at 333, 53 S.Ct. at 391 [77 L.Ed. at 818]:
>
> > "If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

In re Nashville White Trucks, Inc., 22 B.R. 578, 583 (Bankr.M.D.Tenn.1982). Moreover, in *Gardner v. New Jersey*, the Supreme Court emphasized the need for a state to pursue its tax lien within the framework of the federal bankruptcy laws by stating that if a bankruptcy court

lacked the power to address state tax liens, that lack of authority would "seriously impair the power of the court to administer the estate and adversely affect the power of . . . the court to promulgate a reorganization plan." *Gardner*, 329 U.S. at 577, 67 S.Ct. at 473, 91 L.Ed. at 516.

The County, nevertheless, argues that an extinguishment of statutorily provided tax lien costs and fees pursuant to Section 506(b) violates the Tenth Amendment because it interferes with a state's sovereign governmental power to tax real property. The Supreme Court, however, has stated that "State sovereign interests . . . are more properly protected by procedural safeguards inherent in the structure of the federal system than by judicially created limitations on federal power." *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 552, 105 S.Ct. 1005, 1018, 83 L.Ed.2d 1016, 1034 (1985) (holding that there is nothing in the overtime and minimum-wage requirements of the Fair Labor Standards Act that is destructive of state sovereignty or violative of the Tenth Amendment). Although in *Garcia* the Supreme Court was considering only Congress's power to regulate interstate commerce and did not address Congress's power to establish a uniform bankruptcy law, the *Garcia* analysis is applicable to both powers, as both are powers delegated to Congress by the Constitution. *In re Kamstra*, 51 B.R. 826, 832 (Bankr.W.D.Mich.1985). According to *Garcia*, a court may impose a substantive restraint on Congress's establishment of bankruptcy laws, such as holding that extinguishment of tax lien costs and fees under Section 506(b) is unconstitutional, only if the court were satisfied that the interests of local and state government in their tax revenues inherently could not have been represented

in Congress or "the national political process" and that such a holding compensated for the process to consider the need of local and state government tax revenues.

Such a situation does not exist here. Congress chose not to allow fees, costs, or charges unless those were provided for under a consensual agreement. *United States v. Ron Pair Enterprises*, 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290, 298 (1989) (interpreting § 506(b) and stating that "in the absence of an agreement, post-petition interest is the only added recovery available"). Moreover, Section 506(b) does not distinguish between local, state or federal tax liens. Obviously, local, state, and federal tax liens do not arise from a consensual agreement but are statutorily provided for. Therefore, because federal revenue interests are identical to state and local taxing interests, it is clear that state interests were represented in the national political process and were not ignored when Section 506(b) was adopted. *See Kamstra*, 51 B.R. at 832; *Matter of Cropper Co., Inc.*, 63 B.R. 874, 876 (Bankr.M.D.Ga.1986). Thus, this Court holds that, under *Garcia*, Section 506(b) does not violate the Tenth Amendment to the United States Constitution. *See Kamstra*, 51 B.R. at 832.

B. *Disallowance of costs and fees under Section 506(b).*

Judge Lundin ruled that Section 506(b), as interpreted in *Ron Pair Enterprises*, does not allow the County to recover post-petition costs and fees because the County's claim arose by operation of law and not by a consensual agreement. *Brentwood Outpatient Ltd.*, 134 B.R. at 270. Nevertheless, the County claims that *Ron Pair*

Enterprises is not controlling. *See* Reply Brief of Williamson County, Tennessee at 15-16.

Although Tennessee's property tax statute provides for penalties, fees and costs to be collected upon the filing of a suit to enforce a tax lien against real property, *see* TENN.CODE ANN. §§ 67-5-2410(a)(1)(A) (1989) (attorneys fees), 67-5-2421(a) (1989), 8-21-601 (1988), and 8-21-701(55) (Supp. 1991) (court costs), the United States Supreme Court has clearly indicated that, under 11 U.S.C. Section 506(b), "[r]ecovery of fees, costs, and charges . . . is allowed only if they are reasonable and provided for in the agreement under which the claim arose. Therefore, in the absence of an agreement, post-petition interest is the only added recovery available." *Ron Pair Enterprises,* 489 U.S. at 241, 109 S.Ct. at 1030, 103 L.Ed.2d at 298. Hence, because the County's claim is a nonconsensual lien, fees, costs, and charges are not allowable to the County under Section 506(b), notwithstanding the existence of adequate collateral, because of the absence of any contractual entitlement thereto. *Accord Matter of Pointer,* 952 F.2d 82 (5th Cir.1992). *See also* 3 Lawrence P. King, COLLIER ON BANKRUPTCY, ¶ 506.05 at 506-42 (15th ed. 1992). But cf. *In re Anderson,* 28 B.R. 231 (Bankr.N.D.Ga.1983) (holding prior to *Ron Pair* that Section 506(b) authorizes the award of post-petition interest and costs of collection, including reasonable attorneys' fees, to priority secured creditors to the detriment of junior creditors secured by the same property).

Finally, regarding the allowance of the County's costs and fees as unsecured claims, Judge Lundin disallowed the costs and fees as part of the County's claim in toto. On the other hand, one commentator has indicated that

claimants may be allowed to assert additional charges, including fees and costs, as part of an unsecured claim under 506(a). King, COLLIER ON BANKRUPTCY, ¶ 11.05 at 11-47. This Court finds, however, that Judge Lundin's ruling is supported by the Supreme Court's clear holding in *Ron Pair Enterprises* that fees and costs are only allowed under Section 506(b) if they are provided for in a consensual agreement and, therefore, holds that the County's costs and fees are not allowed even as unsecured claims.

C. *Allowance of statutory penalties as part of the County's secured claim.*

The Committee argues that the Bankruptcy Court erred in holding that the County's oversecured claim for real property taxes should include statutory penalties which had not accrued at the date of filing of the Debtor's bankruptcy petition. *See* Brief of Brentwood Outpatient, Ltd. Bondholder Committee at 13 [hereinafter Committee's Brief]. The Committee's argument is essentially that penalties fall within the "fees, costs, or charges" categories explicitly disallowed under Section 506(b) unless the claim arises under a consensual agreement. *See id.* at 17. Judge Lundin reasoned that because tax penalties were disallowed under the old Bankruptcy Act, the absence of a similar disallowing provision in the Bankruptcy Code implies that tax penalties are allowable under the Code. *Brentwood Outpatient Ltd.*, 134 B.R. at 271-72. Judge Lundin bolstered this reasoning with the finding that the legislative history to Section 506(b) does not reveal that that provision was intended to include

penalties. *See id.* at 272. Hence, Judge Lundin specifically distinguished between fees, costs, and charges as being allowed but only as part of an oversecured claim under a consensual agreement, on the one hand, and penalties which are not addressed in Section 506(b), on the other hand.

Courts have split over whether Section 506(b) bars recovery of a post-petition, non-consensual claim for tax penalties. The Fifth Circuit recently held, in a Chapter 11 case, that *Ron Pair Enterprises* dictates that state taxing units are not entitled to post-petition penalties, fees, and costs as part of their secured claims. *Matter of Pointer,* 952 F.2d 82 (5th Cir.1992) (following the Second Circuit's reasoning in *In re Parr Meadows,* 880 F.2d 1540 (2d Cir.1989) that tax penalties are not allowed under 506(b) because the claims arose, not under an agreement, but by operation of law). The Fifth Circuit, however, did not attempt to distinguish between Chapter 11 and Chapter 7 bankruptcy cases. Distinguishing *Parr Meadows,* Judge Lundin noted that that case was converted to a Chapter 7 case and that penalties are treated differently by the Code in Chapter 7 than they are in Chapter 11 cases. *Brentwood Outpatient Ltd.,* 134 B.R. at 272. Judge Lundin also correctly noted that *Ron Pair Enterprises* did not address the allowance of tax penalties under Section 506(b) but addressed the allowance of interest, fees, costs, and charges under that section. *Id.*

On the other hand, one bankruptcy court has specifically held that a taxing authority *is* allowed to collect penalties in Chapter 11 cases. *In re Russo,* 63 B.R. 335, 337 (Bankr.D.Mass.1986) (holding that although the Bankruptcy Code specifically does not allow penalty claims in

Chapter 7 liquidations, the Code does allow tax penalties in Chapter 11 cases). The *Russo* court reasoned that in liquidation, the creditors and not the debtor would be penalized, while in Chapter 11, the debtor continues in business and therefore, bears the penalty. *Id.* Here, this reasoning is confirmed by the Bondholder Committee's opposition to paying the penalties. The stronger reasoning on this issue is that of the *Russo* court and Judge Lundin. Therefore, Judge Lundin's holding on this issue is also affirmed.

D. *Termination date of the accrual of penalties.*

Finally, the County challenges the Bankruptcy Court's determination that the tax penalties accrued only until the effective date of the reorganization plan. Appellant's Brief at 19. The County argues that the unpaid property taxes continue to accrue through the date the taxes are paid. *Id.* The County does not present a strong argument to support its contentions but merely states that for the same state sovereignty arguments it advanced to show that section 506(b) violated the Tenth Amendment, the Bankruptcy Court erred in only allowing accrual of penalties through the effective date of the reorganization plan. *Id.*

Judge Lundin stated that the usual operation under Section 506(b) with respect to oversecured claim holders in reorganization cases is to accumulate interest through the effective date of the plan. *Brentwood Outpatient Ltd.*, 134 B.R. at 274. Judge Lundin thus held that "[o]n the effective date of the plan, the amount of the claim is

fixed, and that amount is then subject to payment consistent with the terms of the plan." *Id.* (citing *In re Apple Tree Partners, L.P.*, 131 B.R. 380, 398-99 (Bankr.W.D.Tenn. 1991)). Indeed, the Bankruptcy Code itself supports this holding. Under 11 U.S.C. § 1141, "after confirmation of a plan, the property dealt with by the plan is free and clear of *all* claims and interests of creditors. . . . " (emphasis added) The effect of allowing penalties to accrue on unpaid property taxes after the effective date of the plan would be to continue to burden the property and, thus, accrual of penalties should end at the effective date of the plan. But cf. *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (5th Cir.1949) (holding that "the appellant was entitled to receive the full amount of the principal debt, together with interest accrued thereon to the date of payment"). For these reasons, this Court affirms Judge Lundin's holding that penalties accrue only through the effective date of the reorganization plan.

IV.

For the reasons stated above, the Court concludes that:

I. Section 506 of the Bankruptcy Code does not violate the Tenth Amendment to the United States Constitution by disallowing the payment of costs and fees as part of an oversecured real property statutory lien because Congress, through its bankruptcy power, may circumvent a state's power to tax.

II. The Bankruptcy Court correctly disallowed Williamson County's claim for costs and fees under Section 506(b) of the Bankruptcy Code because the statutory lien

arose, not by consensual agreement, but by operation of law.

III. The Bankruptcy Court correctly held that Williamson County's oversecured claim for real property taxes should include statutory penalties because neither the Bankruptcy Code nor case law prohibit the allowance of penalties and the penalties would be assessed to the Debtor under a Chapter 11 case.

IV. The Bankruptcy Court correctly held that the accrual of penalties terminated upon the effective date of the reorganization plan because after confirmation of the reorganization plan, the property must be free and clear of all claims and interests of creditors.

In conclusion, the judgment of the Bankruptcy Court is affirmed in all respects.

An order in accordance with this memorandum will be entered.

In re BRENTWOOD OUTPATIENT LTD., d/b/a Brentwood Outpatient Medical Center, Debtor.

Bankruptcy No. 389-05929.

United States Bankruptcy Court, M.D. Tennessee.

Dec. 13, 1991.

MEMORANDUM

KEITH M. LUNDIN, Bankruptcy Judge.

The question is whether Williamson County's over-secured claim for real property taxes includes statutory penalties, fees and costs. The claim includes penalties, but does not include fees and costs.

I.

The debtor filed Chapter 11 in August of 1989. A plan proposed by the Bondholder Committee was confirmed on May 14, 1991. The confirmed plan provides for payment in full of the allowed secured claim of Williamson County.

Williamson County asserts a secured claim for 1989 real property taxes plus interest, penalties, fees and costs. The value of the property securing the County's claim exceeds the amount of that claim. The Bondholder Committee concedes the County's right to post-petition interest, *see United States v. Ron Pair Enterprises,* 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), but the Committee contests the County's claim for statutory penalties, fees and costs.

II.

TENN.CODE ANN. § 67-5-2101 (1989) provides:

> The taxes assessed by . . . a county . . . upon any property of whatever kind, and all penalties, interest, and costs accruing thereon, shall become and remain a first lien upon such property from January 1 of the year for which such taxes are assessed.

TENN.CODE ANN. § 67-5-2010 (1989) provides:

> Penalty and interest. – (a)(1) To the amount of tax due and payable, a penalty of one half of one percent (.5%) and interest of one percent (1%) shall be added on March 1, following the tax due date and on the first day of each succeeding month. . . .

Under TENN.CODE ANN. §§ 67-5-2101 and 2010 (1989), Williamson County's lien for taxes also secures its rights to payment of penalties and costs.[1] At the petition in August of 1989, the County's claim for penalties with respect to 1989 taxes was unmatured and would mature beginning March 1, 1990. That the County's right to payment of penalties was unmatured does not defeat its status as a claim in bankruptcy. *See* 11 U.S.C. § 101(5) (" 'claim' means . . . right to payment, whether . . . matured, unmatured. . . . ").

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[1] The County claims a right to payment of its post-petition attorneys' fees. Although the Tennessee statute mentions "costs" but not "fees," *see* TENN.CODE ANN. § 67-5-2101 (1989), reproduced above, even if "costs" includes attorneys' fees, the County's right to post-petition fees is not contained in an agreement and thus is not allowable in bankruptcy. *See* discussion of § 506(b) *infra*.

Section 502 of the Bankruptcy Code governs *allowance* of claims. Upon objection, § 502(b)(1) disallows any portion of a claim that is unenforceable against the debtor and property of the debtor "under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. § 502(b)(1). Section 502(b)(2) disallows "unmatured interest." 11 U.S.C. § 502(b)(2). Lack of maturity is not a bar to *allowance* of the County's claim for penalties or costs.

"Applicable law" for § 502(b)(1) purposes includes bankruptcy law. The Bondholder Committee cites 11 U.S.C. § 506(b) as "applicable law" that disallows penalties, fees and costs.

Section 506(b) of the Bankruptcy Code addresses entitlement to "interest . . . fees, costs or charges" with respect to oversecured claims:

> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

Section 506(b) reverses the effect of § 502(b)(2) with respect to post-petition interest for oversecured claim holders. In *Ron Pair,* the Supreme Court held that § 506(b) allows post-petition interest to both consensual and non-consensual oversecured claim holders. The Supreme Court interpreted § 506(b) by reference to pre-Code case law and with acute attention to the grammatical structure

of the section. The Court concluded that the rules for allowance of post-petition interest to oversecured claim holders are different from the rules for allowance for fees, costs or charges:

> Recovery of postpetition interest is unqualified. Recovery of fees, costs, and charges, however, is allowed only if they are reasonable and provided for in the agreement under which the claim arose. Therefore, in the absence of an agreement, postpetition interest is the only added recovery available.

Ron Pair, 489 U.S. at 241, 109 S.Ct. at 1030.

Section 506(b) as interpreted by the Supreme Court in *Ron Pair* requires disallowance of Williamson County's claim for post-petition fees and costs because Williamson County's claim arose by operation of law and not by agreement.

III.

The Bondholders argue that *Ron Pair* interprets § 506(b) also to preclude allowance of penalties to an oversecured, nonconsensual lien holder. At least three courts have interpreted *Ron Pair* to affect the allowance of penalties to nonconsensual lien holders. *See In re Parr Meadows Racing Ass'n, Inc.*, 880 F.2d 1540, 1549 (2d Cir.1989); *In re California Wholesale Elec. Co.*, 121 B.R. 360, 366-67 (Bankr.C.D.Cal.1990); *In re Pointer,* 113 B.R. 285, 291 (Bankr.N.D.Tex.1990). In *Parr Meadows,* the Second Circuit precluded secured status for tax penalties on the following theory:

> *Ron Pair* also answers the question whether, under § 506(b), the county is entitled to priority on its penalty claims. Under the bankruptcy code, "[r]ecovery of fees, costs, and charges" is allowed "only if they are reasonable and provided for in the agreement under which the claim arose." In the absence of such an agreement, fees and costs are not recoverable. *Ron Pair,* 109 S.Ct. at 1030.
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> Here, the claims for penalties arose, not under an agreement between the parties, but by operation of law under the tax act. Consequently . . . § 506(b) did not apply to penalties. . . .

880 F.2d at 1549. *California Wholesale Elec., Co.* cites *Parr Meadows* verbatim and reaches the same conclusion, 121 B.R. at 366-67. *In re Pointer* follows *Parr Meadows* but describes as dicta any inference from *Ron Pair* with respect to the allowance of penalties to the holder of an oversecured, nonconsensual lien. 113 B.R. at 291.

Parr Meadows, California Wholesale Elec. Co. and *Pointer* neither cite nor discuss a contrary line of cases dealing with the allowance of penalties to oversecured, nonconsensual lien holders. *See In re Manchester Lakes Assoc.,* 117 B.R. 221 (Bankr.E.D.Va.1990); *Matter of Specialty Cartage, Inc.,* 115 B.R. 164 (N.D.Ind.1989); *In re Stack Steel & Supply Co.,* 28 B.R. 151 (Bankr.W.D.Wash.1983); *In re Mitchell,* 39 B.R. 696 (Bankr.D.Or.1984); *In re Russo,* 63 B.R. 335 (Bankr.D.Mass.1986); *In re Senaca Balance, Inc.,* 114 B.R. 378 (Bankr.W.D.N.Y.1990).

As explained by Judge Bostetter in *Manchester Lakes Assocs., Ron Pair* "did not definitively decide whether

section 506(b) bars recovery of a prepetition, nonconsensual claim for tax penalties." 117 B.R. at 223. In *Ron Pair*, the Supreme Court interpreted § 506(b) in accordance with pre-Code case law. Under § 57j of the former Bankruptcy Act, debts owing to a state or subdivision "as a penalty or forfeiture shall not be allowed. . . . " 11 U.S.C. § 93(j) (repealed 1979).[2] *Manchester Lakes Assocs.*, 117 B.R. at 223. The Supreme Court had interpreted § 57j broadly to prohibit allowance of tax penalty claims without regard to whether the claim was secured or unsecured. *See Simonson v. Granquist*, 369 U.S. 38, 39-40, 82 S.Ct. 537, 538-39, 7 L.Ed.2d 557 (1962).

The Bankruptcy Reform Act of 1978 contains no provision similar to former § 57j applicable to Chapter 11 cases. Several sections of the Code deal specifically with claims for penalties in Chapter 7 cases. Section 726(a)(4) provides for automatic subordination of noncompensatory penalty claims in Chapter 7 cases. Section 724(a) makes liens securing noncompensatory penalty claims voidable by the trustee in a Chapter 7 case. As Judge Bostetter documents, the legislative history of §§ 724 and 726 demonstrates that Congress contemplated that liens securing penalties *would be valid in Chapter 11 cases* following enactment of the Code:

> The Notes of the Committee on the Judiciary Senate Report 95-989 ("Notes") pertaining to section 724(a) indicate that section 724(a) continues section 57(j)'s policy of protecting

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[2] Former § 57j, 11 U.S.C. § 93(j) (repealed 1979), excepted from disallowance "pecuniary loss" sustained by the claimant.

unsecured creditors from the debtor's wrongdoing. The Notes explain:

> [s]ubsection (a) of section 724 permits the trustee to avoid a lien that secures a fine, penalty, forfeiture, or multiple, punitive, or exemplary damages claim to the extent that the claim is not compensation for actual pecuniary loss. *The subsection follows the policy found in section 57j of the Bankruptcy Act of protecting unsecured creditors from the debtor's wrongdoing, but expands the protection afforded.* The lien is made voidable rather than void in chapter 7, in order to permit the lien to be revived if the case is converted to chapter 11, under which penalty liens are not voidable. To make the lien void would be to permit the filing of a chapter 7, the voiding of the lien, and the conversion to a chapter 11, simply to avoid *a penalty lien, which should be valid in a reorganization case.*

S.Rep. No. 989, 95th Cong., 2d Sess. 96, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5882 (emphasis supplied).

Committee Notes applicable to section 726(a)(4) explain:

> [p]aragraph (4) provides that punitive penalties, including prepetition tax penalties, are subordinated to the payment of all other classes of claims, except claims for interest accruing during the case. In effect, these penalties are payable out of the estate's assets only if and to the extent that a surplus of assets would otherwise remain at

> the close of the case for distribution back to the debtor.
>
> *Id.* at 5883.

117 B.R. at 224. *See also In re Specialty Cartage, Inc.*, 115 B.R. at 167-68 ("Consequently, Congress was fully aware of the policies against claims for penalties and the liens which might secure them. Despite this, it consciously decided to respect those liens in Chapter 11 by permitting them to remain undisturbed. Given this congressional decision and the foundational role of non-bankruptcy rights, we should not dismember an otherwise valid secured claim merely because it happens to include a penalty."); *In re Stack Steel & Supply Co.*, 28 B.R. at 155 ("In any event the legislative history to the Code clearly indicates that lien-secured penalties were not intended to be avoidable in Chapter 11 cases. . . . Therefore, as long as this case remains in Chapter 11, this Court is constrained to allow the claim for penalties secured by pre-petition tax liens."); *In re Russo*, 63 B.R. at 337 ("The Code does not allow penalty claims in Chapter 7 liquidations that would impinge on creditors, 11 U.S.C. § 726(a)(4). However, the taxing authority is allowed to collect penalties in Chapter 11. The rationale for the different treatment is that in liquidation the creditors, not the debtor, would be penalized, while in Chapter 11, the debtor continues in business and therefore, bears the penalty."); *In re Seneca Balance, Inc.*, 114 B.R. 378 ("The vitality of a valid tax lien, which includes penalties and interest on the same, has been historically respected by the Legislature and the Judiciary.")

The Supreme Court in *Ron Pair* did not cite or analyze § 57j of the former Act, did not trace the development of §§ 724 or 726 and did not mention the allowance of penalties in Chapter 11 cases. These matters were not before the Court. Although the taxing authority's claim in *Ron Pair* included penalties, allowance of penalties was neither at issue nor addressed by the Court in its decision.

Parr Meadows did not analyze § 57j of the former Act or consider that tax penalty liens are protected in Chapter 11 cases under the Code. *Parr Meadows* was (converted to) a Chapter 7 case. Penalties are treated differently by the Code in Chapter 7 than they are in Chapter 11 cases.[3] *See* 11 U.S.C. §§ 724(a) and 726(a)(4). The *Parr Meadows* court acknowledged that § 726(a)(4) would determine "in what order the county's penalty claims should be satisfied in relation to other creditors . . . [I]f any money remains after the secured creditors' and other, higher priority claims are satisfied, the county can recover its penalty claims from the estate." 880 F.2d at 1549. Section 724(a) works in concert with § 726(a)(4) in Chapter 7 cases to produce the result the Second Circuit seems to have desired. Under § 724(a) the Chapter 7 trustee in *Parr Meadows* could have avoided the (noncompensatory) penalty lien of the taxing authority. The Second Circuit's use of § 506(b) to accomplish what Congress intended for

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[3] The Second Circuit in *Parr Meadows* did not rely upon this distinction to reach its conclusion that nonconsensual liens for penalties are denied secured status.

§ 724(a) is not benign. Section 506(b) applies in all chapters, but Congress intended different treatment for penalty liens outside of Chapter 7.

The *Parr Meadows* holding that nonconsensual penalty liens are not secured because they are not provided for by agreement fails statutory analysis because penalties are not "fees, costs, [or] charges" for purposes of § 506(b). The legislative history to § 506(b) does not reveal that "fees, costs [or] charges" were intended to include "penalties." The drafters of the Bankruptcy Code elsewhere used the world "penalties," "fees," "costs" or "charges" as if their meanings are distinct. *See, e.g.*, 11 U.S.C. § 107(a) (access to court records without "charge"); 11 U.S.C. § 322(c) (trustee not liable personally for "penalty or forfeiture"); 11 U.S.C. § 328(a) ("contingent fee"); 28 U.S.C.S. § 1930 (Law.Co-op.1989) (bankruptcy "fees"); 28 U.S.C.S. § 1930 note on Bankruptcy Court Fee Schedule 819 (Law.Co-op.Supp.1991) ("The clerk shall assess a *charge* of up to three percent. . . . ") (emphasis added); 11 U.S.C. § 507(a)(7)(G) ("the actual, necessary costs"); 11 U.S.C. § 503(b)(1)(C) ("any fine, penalty"); 11 U.S.C. § 503(b)(6) ("the fees and mileage"); 11 U.S.C. § 505(a) ("the amount . . . of any . . . penalty"); 11 U.S.C. § 507(a)(1) ("any fees and charges"); 11 U.S.C. § 726(a)(4) ("fine, penalty, or forfeiture"). *See also* Fed.R.Bankr.P. 7054(b) ("The court may allow costs. . . . ").

The dictionary definitions of these words are dissimilar. "Penalties" conventionally include some concept of punishment. BLACK'S LAW DICTIONARY 1290 (4th ed. rev.1968). "Charges" involve ordinary duties, burdens or obligations. BLACK'S at 294-95. A "fee" usually includes compensation for goods or services. BLACK'S at 740-41.

"Costs" typically include reimbursement of expenses to an officer or agency. BLACK'S at 415-16.

The Tennessee statute that creates the liens here at issue separately identifies the taxing authority's right to recover costs and penalties. *See* TENN.CODE ANN. §§ 67-5-2101 and 67-5-2010 (1989), reproduced above.

In many other contexts, Congress has recognized that "penalties" are different from "fees", "costs" or "charges." *See, e.g.*, 5 U.S.C.S. § 551(10) (Law.Co-op.1989) ("sanction" for purposes of the Administrative Procedure Act includes "imposition of penalty or fine;" assessment of *costs, charges,* or *fees* are separately allowed); 16 U.S.C.S. § 810(b) (Law.Co-op.1978) (*"charges and penalties"* with respect to licensees under Federal Power Act) (emphasis added); 22 U.S.C.S. § 4209 (Law.Co-op.1982) (collection of unlawful *charges and penalties* by consular officers); 43 U.S.C.S. § 465 (Law.Co-op.1980) (*charges and penalties* payable to the Secretary of Interior); 43 U.S.C.S. § 478 (La.Co-op.1980) (construction *charges* and "a *penalty* of [one] per centum thereof" payable by any water right applicant or entryman) (emphasis added); 47 U.S.C.S. § 205 (Law.Co-op.1981) (*charges and penalties* payable to Federal Communication Commission).

The precise use of language and punctuation in § 506(b), on which the Supreme Court relied in *Ron Pair,* favors the conclusion that the section does not address penalties. Such a reading of § 506(b) makes sense of §§ 724 and 726, makes sense of the legislative history of

the Code with respect to former § 57j,[4] accounts for the failure of Congress to reenact § 57j and leaves oversecured claim holders in Chapter 11 cases with the more favorable position that Congress intended for them.

If § 506(b) is inapplicable, no "applicable law" disallows claims for tax penalties in a Chapter 11 case.[5] Penalties to Williamson County that mature post-petition are allowed as part of its oversecured claim.

This interpretation of § 506(b), *Ron Pair* and the conflicting lines of authority leads to one odd outcome. The Code allows penalties to the holder of an oversecured, nonconsensual tax claim in a Chapter 11 case, but § 506(b) and *Ron Pair* preclude allowance of post-petition fees, costs and charges. Arguably, fees, costs and charges are more in the nature of "compensation" than are penalties. Elsewhere, the Code demonstrates Congressional intent to treat compensatory claims by taxing authorities more favorably than non-compensatory claims. *See, e.g.*, 11 U.S.C. §§ 724(a), 726(a)(4) and 507(a)(7)(G) (excluding

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[4] Section 57j of the former Act, 11 U.S.C. § 93(j) (repealed), acknowledged by its own terms that *penalties* and *costs* were distinct concepts: "a *penalty* . . . shall not be allowed, except for . . . pecuniary loss . . . with reasonable and actual *costs*. . . ." (emphasis added).

[5] Not presented is the question whether equitable subordination under 11 U.S.C. § 510(c)(1) should be applied in this or other Chapter 11 cases to affect distributions to penalty lien holders. Also not presented are defenses that might be raised under applicable state law to collection of penalties – e.g., nonbankruptcy restrictions on collection of "penalties" from mortgagors. *See, e.g., Mack Fin. Corp. v. Ireson*, 789 F.2d 1083 (4th Cir.1986).

from the seventh priority penalties related to a tax claim if the penalty is not in compensation for actual pecuniary loss).

History may explain this wrinkle in Chapter 11 cases under the Code. Under the former Bankruptcy Act, *contractual* rights to attorneys' fees, if valid under state law, were enforceable as part of an oversecured claim in bankruptcy. *See Security Mortgage Co. v. Powers*, 278 U.S. 149, 153-54, 49 S.Ct. 84, 85-86, 73 L.Ed. 236 (1928); *In re Martin*, 761 F.2d 1163, 1168 (6th Cir.1985). This rule was not changed with the enactment of the Code. In contrast, as demonstrated above, penalties were not allowed to even an oversecured claim holder by operation of former § 57j. The Congressional decision to eliminate § 57j and to allow penalty claims in Chapter 11 cases left a slight incongruity in the law with respect to "compensatory" fees, costs and charges claimed by nonconsensual lien holders in Chapter 11 Cases.

IV.

The Bondholder Committee argues that the accrual of post-petition interest on the oversecured claim of Williamson County terminates on June 1, 1991, the effective date of the confirmed plan. Because of this litigation, Williamson County was not paid its claim in full on the effective date of the plan and the County asserts its right to continue to accrue interest through the date it is actually paid. There is some authority for this proposition. *See, e.g., Oppenheimer v. Oldham*, 178 F.2d 386, 389 (5th Cir.1949) ("[T]he appellant was entitled to receive the full amount of his principal debt, together with interest

accrued thereon *to the date of payment.")* (emphasis added).

The usual operation of § 506(b) with respect to oversecured claim holders in reorganization cases is that interest accumulates through the effective date of the plan. On the effective date of the plan, the amount of the claim is fixed, and that amount is then subject to payment consistent with the terms of the plan.[6] Because Williamson County is a fully secured claim holder, its claim at the effective date of the plan would be entitled to "present value" in a Chapter 11 case. *See* 11 U.S.C. §§ 1129(a)(7) and 1129(b)(2)(A)(i)(II). Williamson County is thus entitled to accrue interest through the effective date of the plan. After the effective date, Williamson County is entitled to interest through the date of payment to insure payment of the present value of its allowed secured claim.[7]

An appropriate order will be entered.

ORDER

For the reasons stated in the memorandum filed contemporaneously herewith, IT IS ORDERED, ADJUDGED and DECREED that Williamson County's oversecured

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[6] *See, In re Hildreth,* 43 B.R. 721, 722 (Bankr.D.Idaho 1984); *In re Apple Tree Partners, L.P.,* 131 B.R. 380, 398-99 (Bankr. W.D.Tenn.1991).

[7] The rate of interest payable to a nonconsensual, oversecured lien holder under *Ron Pair* and/or § 506(b) for the period from the filing to the effective date of the plan and the rate applicable under § 1129 after the effective date of the plan have not been contested in this proceeding.

claim for real property taxes includes statutory penalties, but not fees and costs. Interest accrues on Williamson County's claim until the effective date of the plan under § 506(b) and thereafter until paid to provide the present value of the County's claim.

IT IS SO ORDERED.

ENTERED this 13 day of December, 1991.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const. Art. I, Sec. 8. Powers of Congress. The Congress shall have power to . . . establish an uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States . . .

U.S. Const. Amend. 10. Rights reserved to states or people. The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.

Tenn. Code Ann. 67-5-2101. Taxes on which lien based. (a) The taxes assessed by the state of Tennessee, a county, or municipality, taxing district, or other local governmental entity, upon any property of whatever kind, and all penalties, interest, and costs accruing thereon, shall become and remain a first lien upon such property from January 1 of the year for which such taxes are assessed.

(b) In addition to the lien on property, property taxes are a personal debt of the property owner or property owners as of January 1, and, when delinquent, may be collected by suit as any other personal debt. In any lawsuit for collection of property taxes, the same penalties and attorney fees shall apply as set forth in § 67-5-2410, for suits to enforce liens for property taxes. The claim for the debt and the claim for enforcement of the lien may be joined in the same complaint.